



# Economic Indicators

Prepared by the Department of Finance • March 2005

*The purpose of this report is to keep policy makers apprised of changes in the national and local economies that the Montgomery County Department of Finance believes may impact current and/or future revenues and expenditures.*



*This report is also available through the Internet on the Montgomery County Web Page:  
<http://www.montgomerycountymd.gov>*

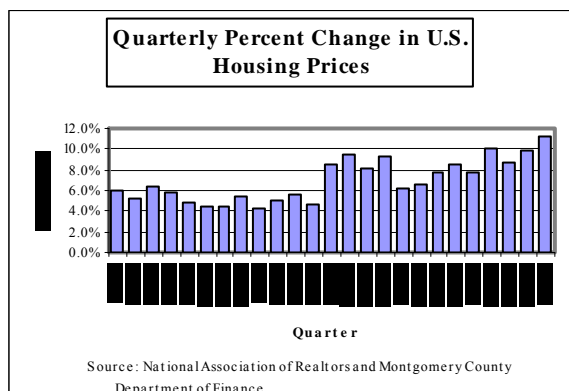
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## ECONOMIC OVERVIEW

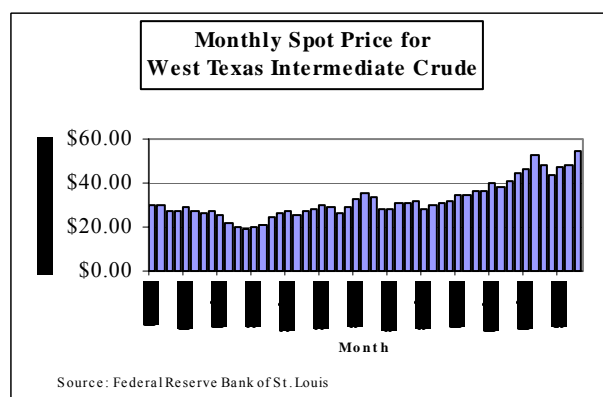
The latest set of economic indicators suggests that the U.S. economy grew at a 3.1 percent annual rate during the first quarter of 2005, based on preliminary data from the Bureau of Economic Analysis, U.S. Department of Commerce. That rate is below the 3.8 percent growth in the fourth quarter of last year and suggests that the economy is showing signs of softening largely attributed to rising inflation, higher short-term interest rates, business investment, and the stock market. Aside from those factors, there was positive economic news during the first quarter. Retail sales increased 7.2 percent up slightly from the 7.0 percent increase over the same period in 2004, and the economy added 477,000 jobs and the unemployment rate stood at 5.2 percent in March. Existing home sales were up 1.0 percent in March and 4.9 percent for the year while average prices were up 3.3 percent for the month and 11.7 percent for the year. New home sales were up 12.2 percent in March and 12.7 percent for the year and average prices declined 3.9 percent for the month but increased 7.8 percent for the year.



With such mixed economic news during the first quarter, the overriding issue in the second quarter is whether energy prices will

continue to increase as we approach the peak driving season of April through September and as such have a significant effect on consumer spending. Such concerns about inflation and a softening of the economy has, in the words of *Barron's*, “investors shuttling in fickle fashion from trepidation about building inflation to worries that the economy has slowed to a trudge.” From the perspective of investors, the economic expansion faces two risks during the second quarter: rising inflation and a slowdown in economic growth. Because of such perspective, the stock market has declined to levels experienced in late October and early November of last year. As of mid-April, all of the major indices declined since the end of December. The NASDAQ experienced the largest decline (↓ 11.2%) followed by the Russell 2000 index (↓ 9.5%).

Crude oil prices, as represented by the West Texas Intermediate (WTI) benchmark surpassed \$57 per barrel in early April after reaching an average of \$54 in March, which at that time was the highest price ever.



According to the Energy Information Agency (EIA), prices for WTI are projected to average nearly \$57 per barrel during the summer, a 37.7 percent increase over last summer. Several factors contributed to high crude oil prices and EIA estimates that such

factors are likely to keep prices near current levels. Those factors include: 1) growth in world oil demand is projected to remain robust with the demand by China to moderate over the next two years, 2) non-OPEC supply has been flat since the fourth quarter of 2003, 3) worldwide crude oil production capacity especially gasoline refinery capacity in the U.S. has either diminished or is operating at full capacity, and 4) geo-political risks from the insurgency in Iraq to political unrest in Venezuela and Nigeria.

According to remarks by Chairman Alan Greenspan before the National Petrochemical and Refiners Association Conference in early April, higher oil prices have slowed the growth of oil demand, but only modestly reflecting a low short-term elasticity of demand. Futures prices for delivery of both West Texas Intermediate and Brent crudes for the summer exceed spot prices. Of special concern, he notes, is the need to add adequate coking and desulphurization capacity to convert the average content of the world's crude oil to lighter and sweeter needs of transportation fuels, particularly gasoline, that must meet environmental requirements.

Because of the surge in oil prices, retail gasoline is expected to average \$2.28 per gallon nationwide, up 38 cents ( $\uparrow$  20%), from last summer's average. According to EIA projections, gasoline prices will peak in May at \$2.35 per gallon but are expected to remain high during the peak summer driving season.

Despite the 0.7 percent increase in the overall producer price index for finished goods in March, the "core" index rose only 0.1 percent for the second month in a row. On a year-over-year basis, the "core" index rose 2.6 percent which was the first rate

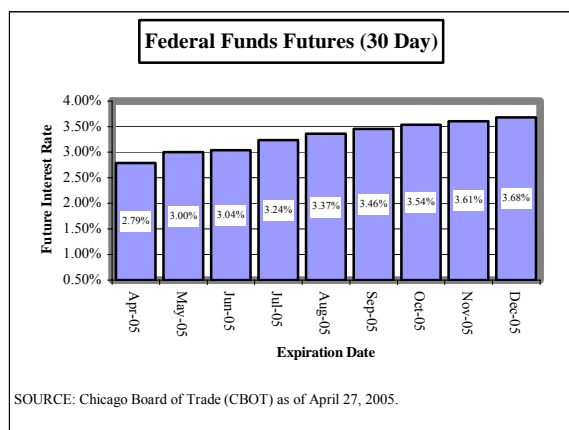
deceleration in eight months. Such modest monthly increases in the past two months and a decline in the year-over-year rate suggests a moderation in inflation.

Meanwhile, until the moderation in producer prices reaches consumer goods and services, "core" consumer prices (CPI) have increased more than the market expected. While the overall CPI rose 0.6 percent, the "core" rate increased 0.4 percent, which was the largest monthly increase since August 2002 and only the fourth such increase in ten years. The largest contributors to the March increase in "core" inflation were hotel and motel costs and owners' equivalent rent (implicit price for owner occupied housing). Those two components accounted for 75 percent of the rise in the "core" index. Rising housing costs are not a one-month factor and have contributed to the substantial rise in the index since March of last year.

Although the spurt in inflation suggests that the Federal Reserve (Fed) may abandon its policy of measured increases in the target rate for federal funds, the market suggests otherwise. The futures market for federal funds estimates that the Federal Open Market Committee (FOMC) will maintain its current policy through the remainder of the year and forecasts

As a rule of thumb, market analysts consider a normal or neutral level for the federal funds rate to be about two percentage points above inflation. With core inflation running at 1.6 percent, such a neutral level means that the rate would increase from its current 2.75 percent to 3.6 percent. The issues are: 1) does the FOMC support a policy of a two-percentage-point spread between core inflation and a neutral federal funds rate, and 2) if so, how fast will the FOMC move to such a level.

Based on recent data from the Chicago Board of Trade (as of April 27, 2005), the futures market for 30-day federal funds expects three more rate increases of 25 basis points each in May, June, and September reaching a level of 3.6 percent by November.



As of April 22nd, the benchmark 10-year Treasury bond dropped 30 basis points since the end of March to 4.26 percent which is nearly the same rate as of December 31<sup>st</sup> (4.24%). With the 10-year Treasury bond declining in April, 30-year mortgage rates also declined 24 basis points in April to 5.80 percent which was the same rate at the end of December (5.81%). However, a recent forecast by Citigroup suggests that the 10-year rate will increase during the second quarter to an average of 4.40 percent compared to 4.30 percent for the first quarter.

The outlook for the national economy during the second quarter remains positive although growing at a slower rate (↑ 3.4%). The U.S. leading economic indicators declined 0.4 percent in March from the prior month and have declined two out of the past three months. Based on the recent forecast by Citigroup, producer prices should continue to moderate (3.7% compared to 4.7% for the first quarter) and the consumer

price index should reach its peak during the second quarter (3.1% compared to an estimated 3.0% for the first quarter). Consumer spending is estimated to pick up during the second quarter (3.8% compared to an estimated 3.2% for the first quarter) offsetting moderations in residential and business investment.

Unlike the national economy, which showed signs of a slowdown during first quarter of 2005, the regional economy rebounded in February from its sluggish performance in January. Despite rising interest rates, higher inflation, and sharp increases in gasoline and energy prices, the Center for Regional Analysis at George Mason University reports that the Washington Coincident Index, which represents the current state of the regional economy, “rebounded nicely with all indicators growing from January as well as from their same-month level in February 2004.” The regional economy added 77,400 in February over February 2004 and the region’s unemployment rate at 3.7 percent remains the lowest among all of the top 15 largest metropolitan areas in the country.

Largely attributed to higher energy prices, consumer spending slowed in February with purchases of durable goods up at an annual rate of 2.0 percent, the lowest twelve-month increase since October 2002. Sales of nondurable goods moderated at an annual rate of 5.9 percent, the lowest year-over-year gain since last August (↑ 3.8%). Overall retail sales in the metropolitan region increased a modest 4.1 percent over last year. At present levels of gasoline prices, CRA estimates that area residents are shifting about \$1 billion from other categories of spending to purchasing gasoline. While such a shift will directly affect vehicle sales, it will have only a

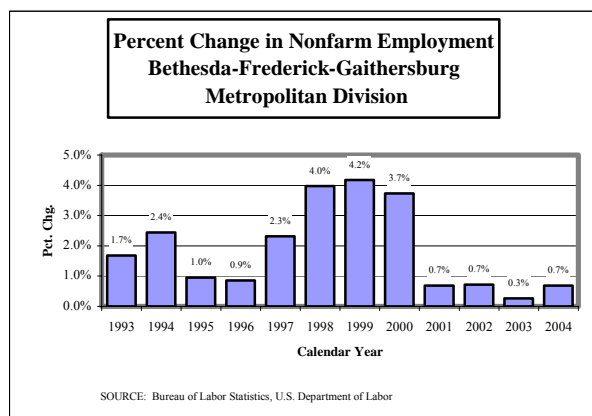
marginal impact on the \$300+ billion regional economy.

It is against this economic backdrop, at the national and regional level, that the economic performance of Montgomery County is analyzed.

## MONTGOMERY COUNTY ECONOMIC INDICATORS

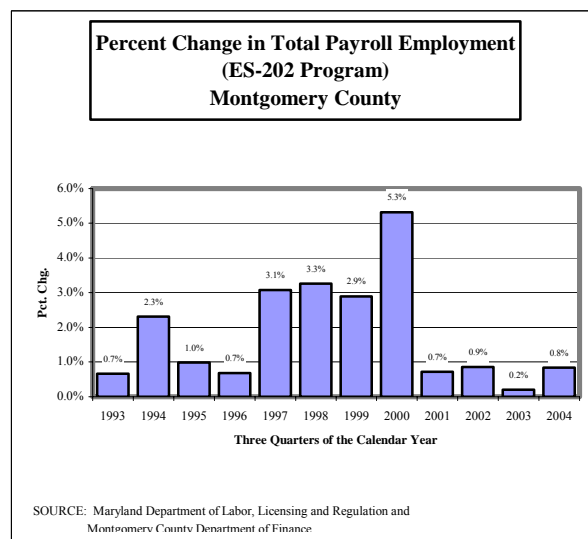
### *Employment Situation*

Based on the preliminary data from the Bureau of Labor Statistics, U.S. Department of Labor, the Bethesda-Frederick-Gaithersburg (B-F-G) metropolitan division showed significant employment growth during the first quarter of 2005 compared to the same period in 2004. The B-F-G region added 9,500 jobs in March compared to March 2004 and nearly 10,400 during the first quarter compared to the same period in 2004 (↑ 1.9%). That increase follows a 0.7 percent rise during 2004. BLS also reported that the B-F-G region's unemployment rate of 3.4 percent in February was the lowest in the Washington metropolitan area and the lowest among the 34 metropolitan divisions throughout the United States.



Based on employment data collected under the State's unemployment insurance

program (ES-202 Program), Maryland's Department of Labor, Licensing and Regulation reported that payroll employment in the County increased 0.8 percent during the first three quarters of 2004, the latest date for which data are available. That increase represents an improvement in the number of new jobs in the County compared to the three previous years when average payroll employment grew 0.6 percent per year.

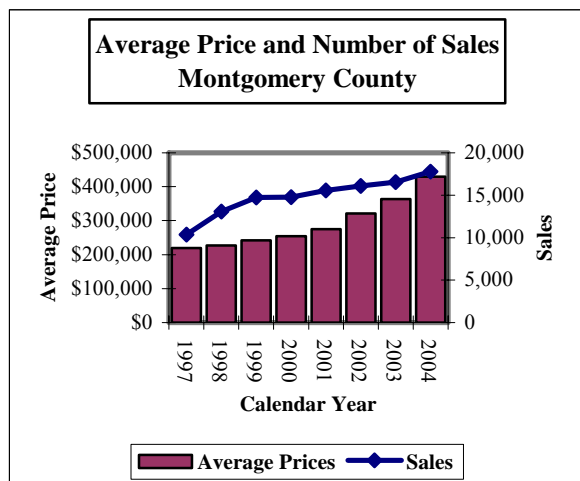


The County's unemployment rate remains one of the lowest in the State. Based on new benchmarks undertaken by BLS and DLLR, the County's rate of 3.4 percent was below the Washington region's average of 3.7 percent, the State's average of 4.6 percent, and the national average of 5.4 percent, data are not seasonally adjusted.

### *Residential Real Estate*

Home sales in the County increased 7.4 percent in 2004, which was significantly higher than the 2.9 percent in 2003. While sales improved in 2004, housing prices continued to accelerate at an 18.3 percent rate in 2004, up considerably from the 13.2 percent in 2003. The average sales price of

a home was nearly \$430,000 compared to less than \$220,000 in 1997.

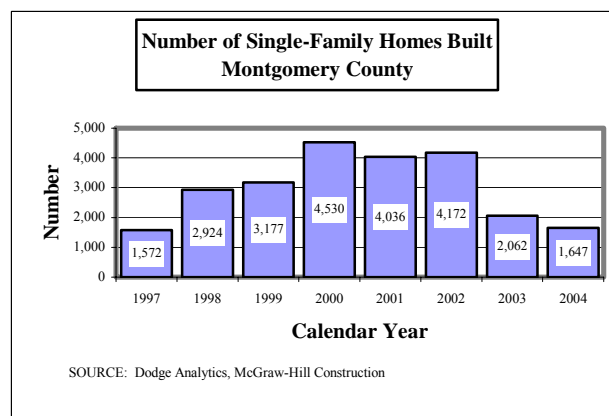


The pace of home sales experienced in 2004 continued through the first quarter of 2004. While home sales increased 5.0 percent compared to the first quarter of 2004. Average prices continued their meteoric rise during the first quarter ( $\uparrow$  17.8%), and if such a trend continues, they may match the 2004 increase.

While such acceleration in housing prices may suggest a price bubble in the County, economic fundamentals suggest otherwise. The reason for the extraordinary price appreciation is attributed to economic and demographic factors. Over the past two years (2003 and 2004), approximately 3,700 single-family units were constructed in the County. During that same period, the number of households increased by 10,000. Therefore, within a two-year period, the increase in households (demand) exceeded the number of new single-family units (supply) by a factor of 2.7 times or a deficit of 6,300. The effect of such an imbalance means that the acceleration of home prices may continue until such time that demand and supply come into balance. Also, a study conducted by PMI Mortgage Insurance Co. calculated the probability of a decrease in

home values to all of the nation's metropolitan regions.

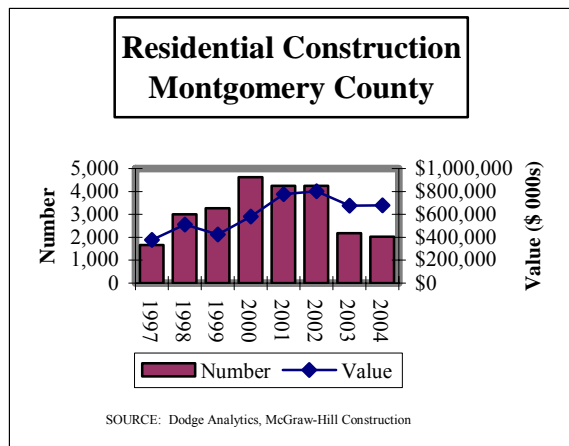
In that study, PMI concluded that there is only a 15 percent probability that home prices will decline over the next two years in the Washington Metropolitan region compared to 53 percent for Boston, 48 percent for San Francisco, and 36 percent for New York. Their conclusions are based on the region's healthy economy especially the region's stable employment situation with solid gains in jobs and low unemployment.



### Construction

Construction activity in the County experienced mixed results in 2004. While the demand for housing in the County remained very strong, construction of residential property remained virtually unchanged compared to 2003. The number of new dwelling units, including multi-family units, declined from 6,900 units (4,180 single-family units, 2,751 multi-family units) in 2002 to 4,700 units (1,650 single-family units, 3,050 multi-family units). The value of new residential and construction increased a meager 0.2 percent in 2004 ( $\uparrow$  \$0.7 million), virtually the same amount in 2003 and slightly above the seven-year average of \$0.6 billion.



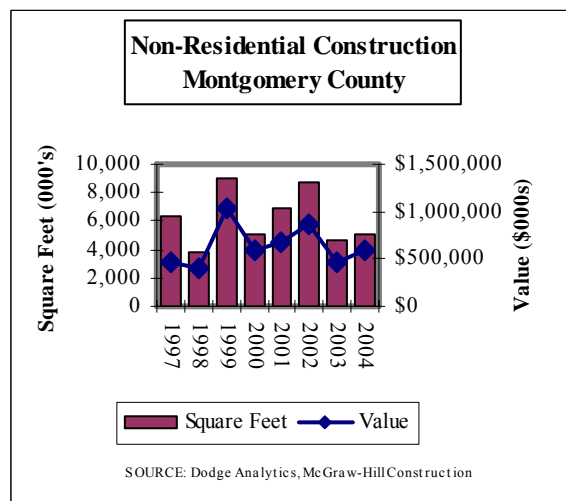


However, during the first quarter of 2005, residential construction picked up dramatically especially construction of multi-family units. With a nearly fivefold increase in the number of construction starts, the value of residential construction increased 36 percent over the same period in 2004. Such an increase in construction of new multi-unit housing and conversion of rental units to condominiums is in response to the growing demand for condominiums in the Washington region.

According to the latest data from the Bureau of the Census, U.S. Department of Commerce, residential housing permits for the County increased nearly threefold in March and 51.3 percent during the first quarter compared to the same period in 2004. While those figures may be encouraging, the fact remains that through the first quarter, residential construction activity was concentrated in multi-family housing rather than single-family dwellings. The issue is whether construction of single-family homes will rebound to meet the growing demand for such units.

In 2004, non-residential construction activity increased in volume, as measured in square feet, up 9.3 percent and in value up 27.1 percent. However, construction during

the first quarter of 2005 showed a much different picture. The volume of added capacity declined 54.3 percent from 2.5 million ft<sup>2</sup> to 1.2 million ft<sup>2</sup> and value of new construction declined 47.4 percent from \$235.5 million to \$123.8 million. The vacancy rate for Class A properties in March decreased slightly from 10.7 percent (March 2004) to 10.3 percent while rental rates were up from \$28.02 per ft<sup>2</sup> in March 2004 to \$28.35 ft<sup>2</sup> in March 2005.

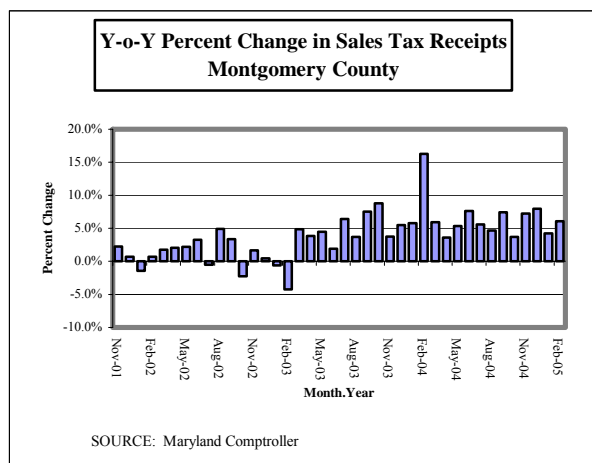


### Retail Sales

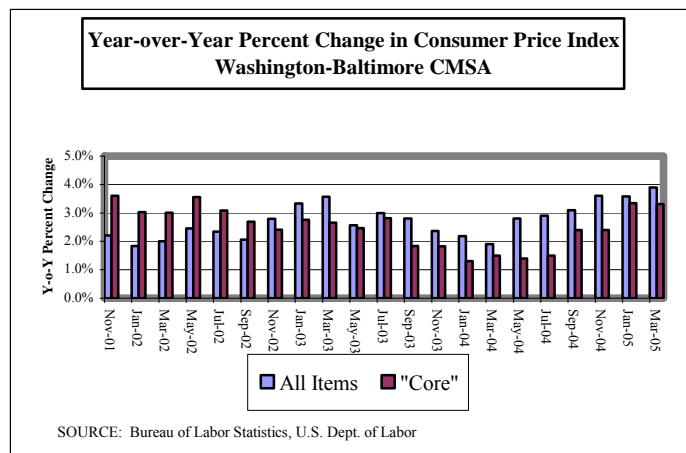
Led by purchases of durable goods, retail sales in the County, as measured by sales tax receipts, increased 6.7 percent in 2004 up from 4.7 percent 2003. The growth in 2004 was the largest increase in over seven years. Sales of durable goods were up 9.7 percent for the year with building and industrial supplies (↑ 18.4%) exhibiting the largest growth following sales of hardware and machinery (↑ 8.1%), furniture and appliances (↑ 6.1%), and automotive sales and products (↑ 4.8%). Purchases of nondurable goods were up 5.9 percent in 2004 largely attributed to utilities and transportation (↑ 8.8%).



Retail sales were up a brisk 6.2 percent in February compared to the same month last year. Based on data for the first two months of this year, sales of durable goods led the increase with purchases up 5.7 percent during the first two months of 2005 compared to the same period last year. Sales of furniture and appliances (↑ 13.2%) and building and industrial supplies (↑ 9.5%) contributed to the brisk sales of durable goods.



increased 3.9 percent in March. That increase was the largest year-over-year increase since the index was developed in 1996. "Core" inflation, which is the overall CPI excluding food and energy, increased 3.3 percent which followed a similar increase in January. This is the largest twelve-month increase in nearly three years.



### *Consumer Prices and Inflation*

Led by surging gasoline and home prices, the overall Consumer Price Index for the Washington-Baltimore Consolidated Metropolitan Statistical Area (CMSA)

SELECTED ECONOMIC INDICATORS	Reporting Period	Current Period	Prior Year's Period	Year To-Date		2003
				2004	2003	
Leading Indicators						
National	Mar	-0.4%		3.0%		3.0%
Washington MSA	Feb	1.4%		1.8%		2.3%
Coincident Indicators						
National	Mar	0.2%		2.6%		1.6%
Washington MSA	Feb	0.9%		7.6%		1.4%
Consumer Confidence Index						
National	Apr	-5.1%		8.3%		17.5%
South Atlantic Region	Apr	-9.5%		11.4%		16.5%
Consumer Sentiment (University of Michigan)	Apr	-4.2%		4.9%		6.8%
Consumer Price Index						
All Items (nsa)						
National	Mar	3.1%		2.7%		2.3%
Washington - Baltimore CMSA	Mar	3.9%		2.8%		2.8%
Core CPI (nsa)						
National	Mar	2.3%		1.7%		1.5%
Washington - Baltimore CMSA	Mar	3.3%		1.8%		2.4%
Retail Trade						
National (sales - nsa)	Mar	7.3%		7.6%		4.4%
Washington MSA (sales - nsa)	Feb	4.1%		7.8%		6.5%
Maryland (sales tax)	Feb	6.5%		9.1%		3.5%
Montgomery County (sales tax)	Feb	6.2%		6.7%		4.0%
Employment						
National (labor force data - nsa)	Mar	139,759,000	137,691,000	139,252,000	137,736,000	137,736,000
- Percent Change		1.5%		1.1%		0.9%
Washington PMSA (labor force data - nsa)	Feb (rev.)	2,738,330	2,687,827	2,712,456	2,669,899	2,669,899
- Percent Change		1.9%		1.6%		1.4%
Montgomery County (labor force data)	Feb (rev.)	492,017		(See footnote to the table below)		
- Percent Change						1.1%
Montgomery County (payroll)*	Sept. '04(adjusted)	450,550	445,098	444,591	442,850	442,850
- Percent Change		1.2%		0.4%		0.5%
Unemployment						
National (nsa)	Mar	5.4%	6.0%	5.5%	6.0%	6.0%
Maryland (nsa)	Feb (rev.)	4.6%	4.5%	(See footnote to the table below)		
Washington PMSA (nsa)	Feb (rev.)	3.7%	3.7%	(See footnote to the table below)		
Montgomery County (nsa)	Feb (rev.)	3.4%	3.1%	(See footnote to the table below)		
Construction						
Construction Starts - Montgomery County						
Total (\$ thousand)	Mar	\$67,470	\$195,433	\$1,259,919	\$1,134,582	\$1,134,582
- Percent Change		-65.5%		11.0%		-31.6%
Residential (\$ thousand)	Mar	\$48,851	\$24,490	\$677,705	\$676,613	\$676,613
- Percent Change		99.5%		0.2%		-15.7%
Non-Residential (\$ thousand)	Mar	\$18,619	\$170,943	\$582,214	\$457,969	\$457,969
- Percent Change		-89.1%		27.1%		-46.5%
Building Permits (Residential)						
National	Mar	185,587	183,359	2,024,211	1,862,365	1,862,365
- Percent Change		1.2%		8.7%		6.6%
Maryland	Mar	3,594	2,312	28,384	30,125	30,125
- Percent Change		55.4%		-5.8%		2.8%
Montgomery County	Mar	833	307	3,798	4,590	4,590
- Percent Change		171.3%		-17.3%		-8.4%
Building Permits (Non-Residential)						
Montgomery County	Mar	339	156	1,966	1,798	1,798
- Percent Change		117.3%		9.3%		-3.2%
Real Estate						
National (saar)						
Sales	Feb	6,790,000	6,400,000	6,784,000	6,183,000	6,183,000
- Percent Change		6.1%		9.7%		9.8%
Median Price	Feb	\$191,000	\$172,000	\$185,200	\$169,500	\$169,500
- Percent Change		11.0%		9.3%		8.5%
Montgomery County						
Sales	Mar	1,218	1,218	17,771	16,534	16,534
- Percent Change		0.0%		7.5%		2.9%
Average Price	Mar	\$468,348	\$388,550	\$429,454	\$362,997	\$362,997
- Percent Change		20.5%		18.3%		13.2%
Median Price	Mar	\$393,450	\$324,140	\$369,900	\$295,500	\$295,500
- Percent Change		21.4%		25.2%		15.5%
Average Days on the Market	Mar	26	28	27	27	27
NOTES:						

## NOTES:

(rev.): Starting with January 2005, the Bureau of Labor Statistics, U.S. Department of Labor, instituted a new method of calculating employment and unemployment. Therefore, data for previous years are not meaningful.

\*Payroll data under 2004 and 2003 pertain to 2003 and 2002 respectively

### METROPOLITAN AREA OFFICE MARKET

#### Office Vacancy Rate by Jurisdiction and Class, 03/05

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudoun	11.43%	10.88%	3.86%	10.81%
Fairfax	14.84%	12.53%	5.76%	13.63%
Frederick	7.09%	25.42%	15.28%	15.61%
Alexandria/Arlington	14.17%	9.08%	18.06%	12.63%
<b>Montgomery</b>	<b>10.33%</b>	<b>10.86%</b>	<b>7.93%</b>	<b>10.32%</b>
District of Columbia	8.28%	7.18%	6.75%	7.72%
Prince George's	13.74%	11.41%	11.60%	12.44%
<i>Metropolitan Area</i>	11.53%	10.11%	9.65%	10.80%

#### Vacant Office Space Inventory by Jurisdiction and Class (sq.ft.)

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudoun	621,115	454,809	20,329	1,096,253
Fairfax	7,764,278	4,200,920	195,766	12,160,964
Frederick	153,402	482,571	85,522	721,495
Alexandria/Arlington	3,013,773	1,713,366	1,136,231	5,863,370
<b>Montgomery</b>	<b>3,002,618</b>	<b>2,892,313</b>	<b>472,219</b>	<b>6,367,150</b>
District of Columbia	5,217,092	3,088,308	837,978	9,143,378
Prince George's	1,252,690	1,018,238	386,213	2,657,141
<i>Region</i>	21,024,968	13,850,525	3,134,258	38,009,751

#### Office Space Inventory by Jurisdiction and Class (sq.ft.)

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudoun	5,433,729	4,179,081	527,062	10,139,872
Fairfax	52,317,661	33,522,188	3,401,062	89,240,911
Frederick	2,164,028	1,898,489	559,654	4,622,171
Alexandria/Arlington	21,263,326	18,864,614	6,292,318	46,420,258
<b>Montgomery</b>	<b>29,073,280</b>	<b>26,644,361</b>	<b>5,955,196</b>	<b>61,672,837</b>
District of Columbia	62,977,860	43,012,821	12,415,122	118,405,803
Prince George's	9,113,914	8,920,309	3,330,767	21,364,990
<i>Region</i>	182,343,798	137,041,863	32,481,181	351,866,842

#### Share of Office Space Inventory by Jurisdiction and Class

<i>Jurisdiction</i>	Class A	Class B	Class C	Total
Loudoun	53.6%	41.2%	5.2%	100.0%
Fairfax	58.6%	37.6%	3.8%	100.0%
Frederick	46.8%	41.1%	12.1%	100.0%
Alexandria/Arlington	45.8%	40.6%	13.6%	100.0%
<b>Montgomery</b>	<b>47.1%</b>	<b>43.2%</b>	<b>9.7%</b>	<b>100.0%</b>
District of Columbia	53.2%	36.3%	10.5%	100.0%
Prince George's	42.7%	41.8%	15.6%	100.0%
<i>Metropolitan Area</i>	51.8%	38.9%	9.2%	100.0%

Note:

Office Space inventory includes leasable and owner-occupied space.

Totals exclude non-classified space.

Vacant means "direct vacant" and does not include sublease space.

Source:

Montgomery County Department of Planning, Research and Technology Center  
Data compiled from Realty Information Group commercial space data file, 3/18/05